

STATE OF CALIFORNIA

190.2710

BOARD OF EQUALIZATION

BUSINESS TAXES APPEALS REVIEW SECTION

In the Matter of the Petitions)	
for Redetermination Under the)	DECISION AND RECOMMENDATION
Sales and Use Tax Law of:)	
)	
S--- C--- W---, INC.)	Nos. SS -- XX XXXXXX-010
)	
E. J. F--- COMPANY, INC.)	SS -- XX XXXXXX
)	
<u>Petitioners</u>)	

The Appeals conference in the above-referenced matters was held by Staff Counsel Lucian Khan on December 7, 1993 in Hollywood, California.

Appearing for Petitioners
(hereinafter "petitioner"):

T--- S---
Vice President - Finance

Appearing for the
Sales and Use Tax Department
(SUTD):

Joseph Cohen
District Administrator

Steven K. Chan
Supervising Tax Auditor

Yeeho Chang
Senior Tax Auditor

Protested Item

S--- C--- W---, Inc. - Disallowance of internal offset for tax-paid construction materials used out of state, measured by \$19,289 for the period July 1, 1989 through December 31, 1989.

E. J. F--- Company, Inc. - Disallowance of internal offset for tax-paid construction materials used out of state, measured by \$102,177 for the period January 1, 1990 through March 31, 1992.

Contention

All California tax-paid material was used on construction jobs in the State of Nevada. Nevada properly assessed a use tax on that same material; therefore, not allowing the internal offset amounts to double taxation.

Summary

Petitioner is a construction contractor involved in the manufacturing and installation of cabinets, and interior woodworks. Effective January 1, 1990, the operations of S--- C--- W--- were merged into E. J. F--- Company. During a routine audit, it was discovered that petitioner offset its use tax liability for purchases of construction materials from out-of-state vendors and used in California, against materials purchased tax-paid from California vendors, but used in construction jobs in the State of Nevada. Because the State of Nevada assessed tax upon the same material which was purchased tax-paid in California, petitioner made the offset. The materials consisted of nails, glue, screws, sandpaper, and lumber, which petitioner shipped to the Nevada --- job sites.

The sandpaper was used for sanding wood at the sites, while the nails, glue, screws and lumber were used for both perimeter woodwork on a structure, and constructing cabinets.

At the conference, petitioner did not dispute it owes tax on the use of the sandpaper. However, it feels the remaining material was either incorporated into a finished cabinet (entitling petitioner to a tax-paid purchases resold deduction) or taxed by the State of Nevada, thus, not allowing a credit would amount to double taxation. Petitioner is faced with the dilemma of not knowing at the time of purchase, whether or not the materials will be used on an out-of-state job. Therefore, a timely exemption certificate cannot be signed in order to avoid California sales tax. Cabinets are constructed in place, at the job site piece by piece, rather than being prefabricated prior to installation. This procedure is necessary because of the design and type of cabinet petitioner is required to construct.

SUTD argues petitioner is not entitled to an offset, because all sales took place, and possession and title passed to petitioner here in California. If petitioner had signed a timely exemption certificate certifying the materials were to be used on out-of-state construction jobs, the purchases would have been exempt. One cannot retroactively sign the exemption certificate. Under Regulation 1521, petitioner is a consumer of materials used in construction contracts.

Analysis and Conclusions

Generally, construction contractors (other than United States construction contractors) are consumers of materials which they furnish and install in the performance of construction contracts, and retailers of fixtures. (Regulation 1521(b)(2)(A), (B).)

The term "materials" includes tangible personal property which is incorporated into, attached to, or affixed to real property and when combined with other tangible personal property loses its identity and becomes an integral and inseparable part of real property, pursuant to the performance of a construction contract. (Reg. 1521(a)(4).) The term "fixture" is defined as an item which is accessory to a building or structure and does not lose its identity when installed. (Reg. 1521(a)(5).) Prefabricated cabinets are considered fixtures when 90 percent of the total direct cost of labor and material in fabricating and installing the cabinet is incurred prior to affixation to the realty. In determining this 90 percent, the total direct costs of all labor and materials in fabricating the cabinet to the point of installation will be compared to the total direct cost of all labor and materials in completely fabricating and installing the cabinet. (Reg. 1521(c)(2).)

Sales tax does not apply to sales of tangible personal property to a construction contractor who holds a valid California seller's permit when the property is used by the contractor outside this state in his performance of a contract to improve real property, provided that at the time of purchase, the contractor certifies in writing to the seller that he holds a valid California seller's permit, provides the number of that permit, identifies the property purchased, and states the property will be used in the manner stated above. Any certificate given subsequent to the time of purchase will not be recognized. (Revenue and Taxation Code Section 6386; Reg. 1521(b)(6)(B); Annotation 190.2730.)

Where a retailer resells tangible personal property before making any use, he may take a deduction for the purchase price of the property if, with respect to his purchase, he reimbursed the vendor for sales tax, or paid use tax. This procedure is allowed where the retailer intended to use the property, but later resells it before making any use, where the property is generally for the use of the retailer, but a small portion is incidentally resold, or where sales or use tax was paid on the purchase in error. (Rev. & Tax. Code § 6012(a)(1), Reg. 1701(a), (b).)

It is clear from the express language of Regulation 1521(b)(6)(B) and Annotation 190.2730, that for petitioner's material purchases from its California suppliers to be exempt, the required exemption certificate must be offered at the time of purchase, and not later. Although petitioner has not satisfied the requirements to obtain this exemption, it may be entitled to the exemption provided under Section 6012(a)(1) and Regulation 1701 for tax-paid

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materials incorporated into a fixture (cabinets) of which petitioner would be deemed the retailer.

Regulation 1521(c)(2) requires that for the cabinet to be considered “prefabricated” and therefore a fixture, 90 percent of the direct total cost of labor and materials in fabricating and installing the cabinet must be incurred prior to affixing it to the realty. There is no express requirement that the prefabrication occur at the contractor's business premises as opposed to the job site. Here, the material from which the cabinet was constructed, was placed on the wall (structure) “piece by piece”, and therefore not prefabricated (90 percent costs incurred) prior to installation. Where cabinets are not prefabricated, but built and installed on the premises of a building, it is not regarded as a fixture, and the contractor is a consumer of materials used. (Annotation 190.1300.) Because of this, petitioner would be considered the consumer (not retailer) of materials used to construct the cabinets, and thus not entitled to a tax-paid purchases resold deduction. Likewise, petitioner is also the consumer of materials which were incorporated into the structure, and sandpaper consumed at the job site. Provided certain requirements are met, however, petitioner may qualify for a tax credit under Revenue and Taxation Code section 6406.

Revenue and Taxation Code Section 6406 provides that persons may be allowed credit against their California use tax liability if they had paid retail sales or use tax to another jurisdiction. The credit may not exceed the taxes imposed by this state, and it must be established that the tax paid to another state was prior to the use in California which gave rise to the California use tax liability. (Annotation 570.1625.) Here, petitioner is not entitled to credit for tax paid to the State of Nevada, because the Nevada tax was not paid prior to the payment of California sales tax. Furthermore, any credit for tax paid to another state is only allowed against the imposition of use tax, and not sales tax. If the situation were reversed such that the initial purchase was made in Nevada and subject to Nevada sales tax, petitioner would then be entitled to credit against its California use tax liability. Whether or not the State of Nevada will allow petitioner credit against its Nevada use tax obligation for the prior payment of California sales taxes is a matter between petitioner and the State of Nevada.

In the future, where at the time of purchase petitioner knows the materials will be used outside California, it should sign the exemption certificate allowed under Section 6386. If petitioner does not know at the time of purchase whether the materials will be used on out-of-state construction jobs, the materials may be purchased under a resale certificate as provided under Regulation 1668 if any of the materials will be incorporated into a fixture of which petitioner will be the retailer (i.e., prefabricated cabinets). Section 6009.1 (“storage and use”-- exclusion) would then exclude from tax materials merely stored in California before being transported from California for consumption in out-of-state construction jobs. If, however, petitioner cannot issue a resale certificate because it never fabricates a fixture as defined under Regulation 1521, then a resale certificate should not be signed. In this instance, the only grounds for exemption would be under Section 6386 if all requirements are met, otherwise petitioner must pay California sales tax.

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Recommendation

Deny both petitions.

Lucian Khan, Staff Counsel

Date